

## Financial Regulatory Developments Focus



In this newsletter, we provide a snapshot of the principal US, European and global financial regulatory developments of interest to banks, investment firms, broker-dealers, market infrastructure providers, asset managers and corporates.

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## Bank Prudential Regulation & Regulatory Capital

### Federal Reserve, OCC and FDIC Announce Amendments to Community Reinvestment Act Regulations

On November 20, 2017, the US Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the US Federal Deposit Insurance Corporation announced changes to their respective regulations under the Community Reinvestment Act. The amendments consist of modifications to the definitions of “home mortgage loan,” and “consumer loan,” to conform to the related amendments made by the Consumer Financial Protection Bureau as part of its implementation of the Home Mortgage Disclosure Act in its Regulation C. The amendments make other conforming changes, including removal of reference to the Neighborhood Stabilization Program, and changes to the public file content requirements of these agencies. These amendments were the subject of a joint notice of proposed rulemaking, published on September 20, 2017, and the Agencies finalized them as proposed. The changes take effect on January 1, 2018.

The interagency final rule is available at: <https://www.occ.treas.gov/news-issuances/news-releases/2017/nr-ia-2017-137a.pdf>.

### Federal Reserve, OCC and FDIC Announce Final Rule Extending the 2017 Regulatory Capital Treatment for Certain Items Under the Regulatory Capital Rules

On November 22, 2017, the Federal Reserve Board, OCC and the FDIC adopted a final rule, applicable to banking organizations that are not subject to the “advanced approaches” under the US regulatory capital rules. The final rule will extend the 2017 regulatory capital treatment for certain items, including mortgage servicing assets, certain deferred tax assets, certain significant and non-significant investments in the capital of unconsolidated financial institutions and certain minority interests. Under the final rule, banking organizations that are not subject to the “advanced approaches” capital rules will continue to evaluate these items in accordance with the risk weight and deduction treatment that was applicable in 2017. This extension does not apply to banking organizations that are subject to the “advanced approaches” capital rules, which will continue to be subject to the transition provisions for these items currently established under the regulatory capital rules. The agencies explicitly noted that the final rule was being issued to prevent different rules from taking effect while the agencies consider a broader simplification of the capital rules which the agencies announced that they intended to do as part of the recent review of regulations under the Economic Growth and Regulatory Paperwork Reduction Act. The final rule takes effect on January 1, 2018.

The final rule is available at: <https://www.occ.treas.gov/news-issuances/federal-register/82fr55309.pdf>.

### European Banking Authority Finalizes Guidelines on the Application of the IRB Approach

On November 20, 2017, the European Banking Authority published final Guidelines on the application of the Internal Ratings-Based approach, in particular, the estimation of risk parameters for non-defaulted exposures, namely of the probability of default (PD) and the loss given default (LGD), and on the treatment of defaulted assets. The Guidelines should be applied in conjunction with the requirements under the Capital Requirements Regulation and the final draft Regulatory Technical Standards on the assessment methodology for national regulators regarding compliance by firms with the requirements to use the IRB Approach.

The Guidelines aim to address concerns raised over the lack of comparability of capital requirements determined under the IRB approach across firms which the EBA raised in its Opinion and Report on the implementation of the regulatory review of the IRB approach to calculating risk-weighted exposure amounts for credit risk, published in February 2016.

The EBA also published a Report on IRB modelling practices used in the estimation of risk parameters for both non-defaulted and defaulted exposures. The Report provides an overview of the practices in IRB modelling as at January 2017 and an assessment of the expected impact that the Guidelines and related RTS will have on the models used by

some firms. The EBA notes that the materiality of the changes must be assessed and treated under the RTS on the materiality of extensions and changes to IRB Approach and Advanced Measurement Approach.

The Guidelines will apply from January 1, 2021.

The final Guidelines are available at:

<http://www.eba.europa.eu/documents/10180/2033363/Guidelines+on+PD+and+LGD+estimation+%28EBA-GL-2017-16%29.pdf>, the EBA's Report on IRB modelling practices is available at:

<http://www.eba.europa.eu/documents/10180/1720738/EBA+Report+on+IRB+modelling+practices.pdf>, the final draft RTS on the assessment methodology for national regulators regarding compliance by firms with the requirements to use the IRB Approach is available at:

<https://www.eba.europa.eu/documents/10180/1525916/Final+Draft+RTS+on+Assessment+Methodology+for+IRB.pdf/e8373cbc-cc4b-4dd9-83b5-93c9657a39f0>, the RTS on the materiality of extensions is available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:JOL\\_2014\\_148\\_R\\_0008](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:JOL_2014_148_R_0008) and the EBA's Opinion and Report on the implementation of the IRB approach is available at: <http://www.eba.europa.eu/-/eba-sets-out-roadmap-for-the-implementation-of-the-regulatory-review-of-internal-models>.

### **2017 Global Systemically Important Banks List Published**

On November 21, 2017, the Financial Stability Board published the 2017 list of Global Systemically Important Banks. The list was compiled using end-2016 data and the 2013 assessment methodology designed by the Basel Committee on Banking Supervision. The Basel Committee has proposed a revised assessment framework for G-SIBs but has not yet published the finalized version. The 2013 framework identifies G-SIBs by assessing their contribution to systemic risk and imposes higher capital requirements on G-SIBs to reduce the likelihood of their failure. Identified G-SIBs are placed into buckets based on their score of systemic importance. G-SIBs are also subject to Total Loss Absorbing Capacity requirements, higher resolvability requirements and higher supervisory expectations on risk management, risk data aggregation capabilities, risk governance and internal controls.

The G-SIB list comprises 30 banks. The 2017 list is largely the same as the 2016 list, except that the Royal Bank of Canada has been added, and Groupe BPCE has been removed.

The list of G-SIBs is available at: <http://www.fsb.org/wp-content/uploads/P211117-1.pdf> and the Basel Committee 2013 assessment methodology is available at: <https://www.bis.org/press/p171121.htm>.

## **Conduct & Culture**

### **UK Financial Conduct Authority Publishes Note on the Compliance Function Within Wholesale Banks**

On November 23, 2017, the Financial Conduct Authority published a note on the compliance function in wholesale banks. The note sets out the key themes and issues arising from responses to an FCA questionnaire which was sent to 22 firms as well as the FCA's own observations. The questionnaire was sent to large global banks operating across several business lines, medium-sized firms focusing on specific areas or geographies and smaller UK firms, in order that the FCA could gain insight into how the function has changed over the past few years. The key themes are that compliance functions need to evolve in response to changes impacting the industry and that more strategic thinking is needed. The FCA has not asked individual firms to take any steps in response to the note. However, the FCA indicates that all firms and heads of compliance should use the note to develop their compliance function.

The FCA's note is available at: <https://fca.org.uk/publication/research/the-compliance-function-in-wholesale-banks.pdf>.

## Derivatives

### Commodity Futures Trading Commission Issues No-Action Relief to Swap Execution Facilities From Timing Requirements for Certain Reporting

On November 20, 2017, the Commodity Futures Trading Commission Division of Market Oversight issued no-action relief to Swap Execution Facilities and their chief compliance officers from certain timing requirements regarding annual compliance reports and fourth quarter financial reports. SEF CCOs are required to file the compliance report with the CFTC no later than 60 calendar days after the end of the SEF's fiscal year, and a SEF must concurrently file its fourth quarter financial report with the CFTC within that same time frame. Multiple SEFs have cited difficulty complying with CFTC time constraints. The relief provides SEFs and their CCOs an additional 30 calendar days to concurrently file the compliance report and fourth quarter financial report with the CFTC, such that the reports will now be due no later than 90 calendar days after the end of the SEF's fiscal year.

The relief, issued under CFTC staff letter 17-61, is set to expire November 30, 2020.

The Press Release is available at: <http://www.cftc.gov/PressRoom/PressReleases/pr7648-17#PrRoWMBL> and CFTC Staff Letter 17-61 is available at: <http://www.cftc.gov/idc/groups/public/@llettergeneral/documents/letter/17-61.pdf>.

## Financial Crime

### Two Charged by UK SFO as Unaoil Bribery Investigation Deepens

On November 16, 2017, the UK Serious Fraud Office charged two individuals in relation to the SFO's ongoing bribery investigation into Unaoil.

Ziad Akle (Unaoil's former territory manager for Iraq) and Basil al-Jarah (Unaoil's former business partner in Iraq) have both been charged with conspiracy to make corrupt payments, contrary to the Criminal Law Act 1977 and the Prevention of Corruption Act 1906. It is alleged that the payments were made between June 2005 and August 2011 in order for Unaoil's client, SBM Offshore, to secure various contracts in Iraq.

A third individual, Saman Ahsani, is currently subject to an extradition request to Monaco on related charges.

The SFO launched its investigation into Unaoil in March 2016 following a series of reports (which were published in the Australian media) alleging corrupt behavior by a number of international corporations seeking to secure business in the Middle East. The SFO is investigating Unaoil, its officers, employees and agents in respect of various alleged offenses of bribery, corruption and money laundering.

Mr. Akle and Mr. al-Jarah will appear before Westminster Magistrate's Court on December 7, 2017.

The SFO press release is available at: <https://www.sfo.gov.uk/2017/11/16/two-charged-sfos-unaoil-investigation/>.

## Funds

### International Organization of Securities Commissions Publishes Good Practices for the Voluntary Termination of Investment Funds

On November 23, 2017, the International Organization of Securities Commissions (IOSCO) published a final report on good practices for the voluntary termination of investment funds which takes into account investors' interests during the termination process. The good practices do not override any legal or regulatory requirements or insolvency regimes. The report covers open-ended and closed-ended investment funds and retail investment funds as well as funds for professional investors. Additional good practices are included for funds established as commodity funds, real estate funds or hedge funds because illiquid or hard-to-value securities can impact the voluntary termination of a fund. These good practices should be read in conjunction with the IOSCO Objectives and Principles of Securities Regulation.

The Report is available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD588.pdf> and the Objectives and Principles of Securities Regulation are available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf>.

## MiFID II

### EU Technical Standards Aligning Indirect Clearing Requirements for MiFID II and EMIR Published

On November 21, 2017, the final RTS Standards under the Markets in Financial Instruments Regulation on indirect clearing arrangements for exchange-traded derivatives and amending RTS under the European Market Infrastructure Regulation on indirect clearing arrangements for OTC derivatives were published in the Official Journal of the European Union. The versions published are equal to those which were adopted by the European Commission on September 22, 2017. Indirect clearing refers to a situation where two or more entities are intermediaries standing between a client and a CCP in a contractual chain. EMIR established RTS on indirect clearing arrangements applicable to OTC products, and MiFID extends these rules and principles to exchange-traded products. The EMIR RTS is now being revised to align with the new MiFIR RTS. Both pieces of legislation allow for indirect clearing arrangements to be set up and establish structures intended to result in equivalent protections for indirect clearing to those available for direct clearing (where only one intermediary exists). Various requirements in relation to segregation and portability at client, clearing member and CCP level are established and new required procedures to manage client defaults apply at clearing member level. Two new kinds of accounts must be established at client, clearing member and CCP level which enable such persons to distinguish indirect client positions and collateral from own account client positions and collateral.

The RTS and the amending RTS will enter into force on December 11, 2017 and will apply from January 3, 2018.

The RTS on indirect clearing under MiFIR is available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2154&from=EN>, the amending RTS on indirect clearing under EMIR is available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2155&from=EN> and the existing RTS on indirect clearing under EMIR is available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1511429814156&uri=CELEX:32013R0149>.

### Court of Justice of the European Union Ruling on Scope of a Regulated Market Under MiFID

On November 16, 2017, the Court of Justice of the European Union gave a preliminary ruling on the meaning and scope of “regulated market” under the Markets in Financial Instruments Directive following a referral by the Dutch Administrative Court of Appeal for Trade and Industry. A regulated market is defined in MiFID I as “a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments—in the system and in accordance with its non-discretionary rules—in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorized and functions regularly and in accordance with the provisions of Title III.” The definition is unchanged in MiFID II which will replace MiFID I from January 3, 2018.

The request for a preliminary ruling arose out of a dispute between ‘open ended’ investment funds using the Euronext Fund Services system (EFS system) to trade shares in their funds and the Autoriteit Financiële Markten, the Dutch financial markets authority. The AFM had imposed a series of charges on the investment funds under the Dutch law implementing MiFID I, because it determined that the investment funds were issuers and that the EFS system was a regulated market. The EFS system is operated by Euronext, an authorized regulated market.

The CJEU was asked whether a regulated market “covers a trading system in which multiple fund agents and brokers represent, respectively, ‘open end’ investment funds and investors, the sole purpose of which is to facilitate those investment funds in their obligation to execute the purchase and selling orders for shares placed by those investors.” The

Court noted that the EFS system does display some characteristics of a regulated market in that it is operated by Euronext (an operator of regulated markets), is subject to certain non-discretionary rules and an order placed by a broker with an agent of an investment fund results in a contract relating to the shares in that fund. The Court did not accept that the EFS system is a bilateral system and agreed that the fact that the agents and their investment funds are only required to execute orders to issue or purchase shares in investment funds that they receive via the EFS system does not prevent multiple buying and selling interests from being brought together due to the presence of those agents and brokers within the system. Furthermore, the Court agreed with the AFM that certain characteristics, such as the requirement to report transactions executed through the system, were not necessary for the EFS system to be characterized as a regulated market. Similarly, the Court stated that the degree of risk of abuse in the execution of transactions on the EFS system was not a necessary factor to take into account in the characterization of the system as a regulated market.

The CJEU held that the EFS system did “cover a trading system in which multiple fund agents and brokers represent, respectively, ‘open end’ investment funds and investors, the sole purpose of which is to facilitate those investment funds in their obligation to execute the purchase and selling orders for shares placed by those investors.” The Dutch court must now make its decision on the particular case, taking into account the ruling of the CJEU.

The provisional text of the judgment is available at: <http://www.bailii.org/eu/cases/EUECJ/2017/C65815.html>.

## Payment Services

### European Commission Concludes That the SEPA Regulation Does Not Require Amending

On November 23, 2017, the European Commission published a Report to the European Parliament and the Council of the European Union on the application of the SEPA Regulation. The SEPA Regulation establishes technical and business requirements for credit transfers and direct debits in euro to allow electronic payments in euro without distinguishing between national and cross-border payments. The Commission is charged, under the SEPA Regulation, with reporting on the application of the Regulation and proposing legislative changes, if appropriate. The Commission has concluded that the SEPA Regulation is applied correctly across the EU and that a legislative proposal is unnecessary. The Report notes that identified issues, such as IBAN discrimination, have been addressed by Member States and their resolution will need to be closely monitored.

The Report is available at: <http://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-683-F1-EN-MAIN-PART-1.PDF> and the Annex to the Report is available at: <http://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-683-F1-EN-ANNEX-1-PART-1.PDF>.

## Securities

### European Commission Receives Recommendations on Improving the European Corporate Bond Markets

On November 20, 2017, the European Commission published a Report of the Commission Expert Group on Corporate Bonds on improving the European corporate bond markets. The review of the EU corporate bond market is part of the European Commission's Capital Markets Union.

The Expert Group makes 22 recommendations which relate to six objectives for improving the functioning of the corporate bond markets in the EU. The recommendations include, among others, amending the Market Abuse Regulation to ease the market sounding requirements although no specific recommendations on how to achieve that are made. The requirements have been viewed as imposing disproportionate burdens on companies, underwriters and other persons. The Expert Group considers that the requirements are aimed at large and liquid markets and not the more local, less liquid markets, such as the corporate bond markets and that the effect of the burdensome requirements may deter

intermediaries from conducting market soundings and also deter the less frequent issuers from carrying out new issuances.

The Group also recommends adjusting the treatment of corporate bonds in capital and liquidity requirements, in particular, the Liquidity Coverage Ratio, the Net Stable Funding Ratio and the Leverage Ratio and promoting convergence in interpretation by Member States of the marketing rules for Alternative Investment Funds and Undertakings for Collective Investment in Transferable Securities. The Expert Group also urges the Commission to accelerate its plans to introduce a recommendation on private placements, so as to encourage private placements of corporate bonds and share the good practices developed in some Member States with other Member States. The Expert Group further recommends that the European Commission and the European Securities and Markets Authority assess the impact that different EU legislation has on the corporate bond markets, consolidate overlapping and inconsistent requirements and set up a specialist industry group to advise regulators on how to adapt the framework for corporate bonds.

The Expert Group calls on the Commission to set out a clear way to bring about the implementation of the recommendations. The recommendations were discussed at a public hearing on November 24, 2018.

The Report is available at: [https://ec.europa.eu/info/sites/info/files/171120-corporate-bonds-report\\_en.pdf](https://ec.europa.eu/info/sites/info/files/171120-corporate-bonds-report_en.pdf) and the related Study on Drivers of Corporate bond market liquidity in the European Union is available at [https://ec.europa.eu/info/sites/info/files/171120-corporate-bonds-study\\_en.pdf](https://ec.europa.eu/info/sites/info/files/171120-corporate-bonds-study_en.pdf).

## People

### Chair of the Federal Reserve Board Janet Yellen to Step Down

On November 20, 2017, Janet Yellen, Chair of the Federal Reserve Board submitted her resignation as Chair and as a Member of the Federal Reserve Board. Chair Yellen's resignation will become effective upon the swearing in of the new Chair.

The Federal Reserve press release regarding Chair Yellen's announcement is available at: <https://www.federalreserve.gov/newsevents/pressreleases/other20171120a.htm>.

## Upcoming Events

November 30, 2017: ECB public hearing on proposed Guidance on quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for non-performing exposures

December 5, 2017: Senate Banking Committee markup of (S. 2155), the "Economic Growth, Regulatory Relief, and Consumer Protection Act."

January 16, 2018: EBA consultation on Pillar 2 draft Guidelines

January 22, 2018: EBA public hearing on draft RTS on the methods of prudential consolidation under the CRR

## Upcoming Consultation Deadlines

November 30, 2017: ESMA consultation on Guidelines for non-significant benchmarks

November 30, 2017: European Commission consultation on proposals for statutory prudential backstops to address NPL build-up

December 4, 2017: Joint Money Laundering Steering Group consultation on minor revisions to JMLSG Guidance

December 8, 2017: ECB consultation on proposed Guidance on quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for non-performing exposures

December 19, 2017: EBA consultation on significant risk transfer in securitization

January 12, 2018: PSR consultation (CP17/2) on authorized push payment scams

January 15, 2018: ESMA consultation on proposed Guidelines on the position calculation under EMIR

January 16, 2018: European Commission Legislative Proposals for Enhanced Powers for European Supervisory Authorities and the European Systemic Risk Board

January 25, 2018: ESMA consultation on amendments to Systematic Internalisers' quote rules under RTS 1 of MiFID II

January 31, 2018: EBA consultation on Pillar 2 draft Guidelines

February 2, 2018: BoE consultation on the procedure for the Enforcement Decision Making Committee

February 5, 2018: FCA consultation: Industry Codes of Conduct and Discussion Paper on FCA Principle 5

February 9, 2018: EBA consultation on draft RTS on the methods of prudential consolidation under the CRR

February 15, 2018: Comments due on the Federal Reserve's proposed guidance on supervisory expectations for boards of directors and its proposed new rating system for large financial institutions



This newsletter is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired. If you wish to receive more information on the topics covered in this publication, you may contact your usual Shearman & Sterling representative or any of the following:

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